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M E M O R A N D U M

DATE: May 29, 2002

TO: Metropolitan King County Councilmembers

FROM: Cheryle A. Broom, County Auditor

SUBJECT: Financial Related Audit of the Facilities Management Fund

Attached for your review is the audit report of the Facilities Management Fund. The audit objective was to determine whether the fund achieved the goals of enhanced accountability and increased visibility of costs, which were the goals stated in the rationale for creating the fund.

The general audit conclusions were:

- The Facilities Management Fund did not fully meet the goals of enhanced accountability and increased visibility of costs.
- The framework for the rate models was reasonable, but changes in their methodology and calculations would improve the Facilities Management Division's ability to recover its costs and provide a more equitable distribution of costs among agencies.
- Accounting for revenues and expenditures in the fund was inconsistent with generally accepted accounting principles for internal service funds.
- The fund did not comply with the county's fund balance policy and had large fluctuations in its fund balance.

Our recommendations focus on the need to correct the rate models to more accurately reflect the actual costs of the services provided, to provide more equitable distribution of those costs among county agencies, and to comply with generally accepted accounting principles and state law.

The executive's response to the audit is included as Appendix 6. The response indicates that the audit report will be used as a tool to assist in improving the administration of King County. Although the response disagrees with some of our audit findings and does not specify which recommendations will be implemented, division management subsequently indicated that they intend to review the rate models and implement our recommendations as part of the 2003 budget process.

In addition, we asked the executive to indicate how any similar conditions in other internal service funds will be identified and addressed. The executive response does not address this issue, and we are working with the Executive Audit Services to determine the planned actions.

The Auditor's Office appreciates the cooperation received from management and staff in the Facilities Management Division during this audit.

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Attachment

FINANCIAL RELATED AUDIT

FACILITIES MANAGEMENT FUND

Presented to
the Metropolitan King County Council
by the
County Auditor's Office

Cheryle A. Broom, CGFM, CIG, King County Auditor
Harriet Richardson, CPA, CIA, Principal Management Auditor
Mac Fletcher, CPA, Principal Financial Auditor
Nancy McDaniel, Senior Management Auditor
Jan Lee, Auditor Assistant

Report No. 2002-03

TABLE OF CONTENTS

Abbreviations

COLA	Cost of Living Allowance
CX	Current Expense
DCFM	Department of Construction and Facilities Management
FTE	Full-Time Equivalent
GAAFR	Governmental Accounting, Auditing and Financial Reporting
GAAP	Generally Accepted Accounting Principles
HVAC	Heating, Ventilation, and Air Conditioning
RCW	Revised Code of Washington

REPORT SUMMARY

Introduction

The Facilities Management Fund is the internal service fund for the Division of Facilities Management (the Department of Facilities Management, or DCFM, prior to 2002). The fund was established in 1995 based on DCFM's rationale that an internal service fund would increase accountability and visibility of costs for building operations, maintenance, and minor renovation work.

Audit Objective and Scope

The audit objective was to determine whether the fund achieved the goals identified by DCFM. The audit focused on the 2001 rate models that set the square foot rates for building operations and maintenance and the hourly rates for minor renovation work, and the assumptions DCFM used to set the target fund balance.

General Conclusions

The general audit conclusions are that:

- The Facilities Management Fund did not meet the objectives of enhanced accountability and increased visibility of costs because DCFM did not publish the rates or provide agencies enough information to understand the basis of their charges.
- The framework for the rate models was reasonable but changes in the rate model methodology and calculations would improve DCFM's ability to recover its costs and provide a more equitable distribution of costs.
- Accounting for revenues and expenditures in the fund was inconsistent with generally accepted accounting principles for internal service funds.
- The financial plan for the fund was fairly stated. However, the fund did not comply with the county's fund balance policy, which resulted in large fluctuations in the fund balance. These fluctuations could indicate that agencies were inappropriately charged for services or potentially disrupt DCFM operations due to an insufficient cash balance.

SUMMARY OF MAJOR FINDINGS AND RECOMMENDATIONS

Finding 2-1 (Page 7)	**The Facilities Management Fund did not meet the objectives of enhanced accountability and increased visibility of costs as stated in the fund development plan.** Agencies were not provided sufficient information to determine what they were getting for their money, and the rate models were never reviewed for errors in methodology or calculations. In addition, allocation of some costs was inconsistent with the general rate model methodology, and the rates were not adjusted to account for offsetting revenues as required for internal service funds. **The audit recommends** that DCFM provide agencies information on how the rates are calculated and all costs that are factored into the rates; revise the rate models to correct errors in the methodology and calculations and to account for offsetting revenues; ensure that the models are reviewed and validated after any major changes; and publish the updated rates.
Finding 2-2 (Page 14)	**The conceptual framework for the rate models was reasonable; however, changes in their methodology and calculations would improve DCFM's ability to recover its costs and distribute the costs more equitably.** Although the rates are intended to generate enough revenue to recover DCFM's expenditures, for the last four years the actual revenue was less than the budgeted expenditures, and the rate models were not adjusted based on the variances. Moreover, methodology flaws and calculation errors impacted revenues generated by the square foot and hourly rates and caused inequitable distribution of costs, both among the rate models and

among tenant agencies. Additionally, DCFM did not incorporate a depreciation factor into the rates to build a fund balance for asset replacement.

The audit recommends that DCFM compare each year's actual and projected revenues and expenditures, analyze the differences to determine their cause, and revise the rate models accordingly; revise the square foot rate model to allocate overhead costs more equitably among tenants; revise the hourly rate models to ensure they reflect actual labor and overhead costs; and develop a plan for asset replacement to use as a basis for incorporating a fund balance factor into the rate models.

Finding 2-3 (Page 24) **Accounting for the county parking lots is inconsistent with the requirements for internal service funds and does not comply with state law.**

The costs were not discretely accounted for and the rates were set at market rather than on a cost-reimbursement basis as required for internal service funds. Moreover, a portion of parking revenue was earmarked to the Children and Family Set-Aside Fund, which is inconsistent with generally accepted accounting principles and state law.

The audit recommends that DCFM review their accounting practices to determine whether the parking lots would be more appropriately accounted for in an enterprise fund or the current expense, or retained in the Facilities Management Fund. If retained in the fund, DCFM should discretely account for parking lot costs so the rates can be set on a cost-recovery basis. We also recommend that the Metropolitan King County Council consider working with staff from the Prosecuting Attorney's Office and the State Auditor's Office to ensure that earmarking a portion of the parking revenue to another fund does not violate state law.

Finding 3-2 (Page 33)

The Facilities Management Fund's financial plan is not used as a management tool, resulting in substantial fluctuations in the fund balance. Moreover, the fund does not comply with the county's fund balance policy.

The Facilities Management Fund balance fluctuated significantly from year to year because the fund did not comply with county fund balance policies and the financial plans were not used to monitor the fund. The fluctuations could be an indicator that agencies were inappropriately charged because the rates did not reflect actual costs. They could also potentially disrupt DCFM operations due to an insufficient cash balance.

The audit recommends that DCFM management use the financial plan as a monitoring tool and develop a plan to establish a fund balance that would be factored into the rate models.

Executive Response

The executive response (see Appendix 6) indicates that the audit will be used as a tool to assist in improving the administration of King County. Although the response disagrees with some of our audit findings, DCFM management indicated that they intend to review the rate models and implement our recommendations as part of the 2003 budget process. Appendix 7 contains our comments to the executive response.

In addition, we requested the executive to indicate how any similar conditions in other internal service funds will be identified and addressed; however, the response does not address this issue.

AUDITOR'S MANDATE

The Facilities Management Fund in the Division of Facilities Management was reviewed by the County Auditor's Office pursuant to Section 250 of the King County Home Rule Charter and Chapter 2.20 of the King County Code. The audit was performed in accordance with generally accepted government auditing standards, with the exception of an external quality control review.

1 INTRODUCTION

Introduction

The audit of the Facilities Management Fund was included in the Auditor's Office 2001 work program. The Metropolitan King County Council requested the audit to determine whether the objectives that prompted the 1994 decision to create the fund have been realized.

Background

Establishing the Facilities Management Fund

The Facilities Management Fund is the internal service fund for the Division of Facilities Management[1] and is one of eleven county internal service funds. Internal service funds are intended to be financially self-supporting in that they capture the revenues and expenditures for goods and services provided to other county agencies on a cost-reimbursement basis.[2] Revenues and expenditures in internal service funds may fluctuate with changing service levels and consumer demand.

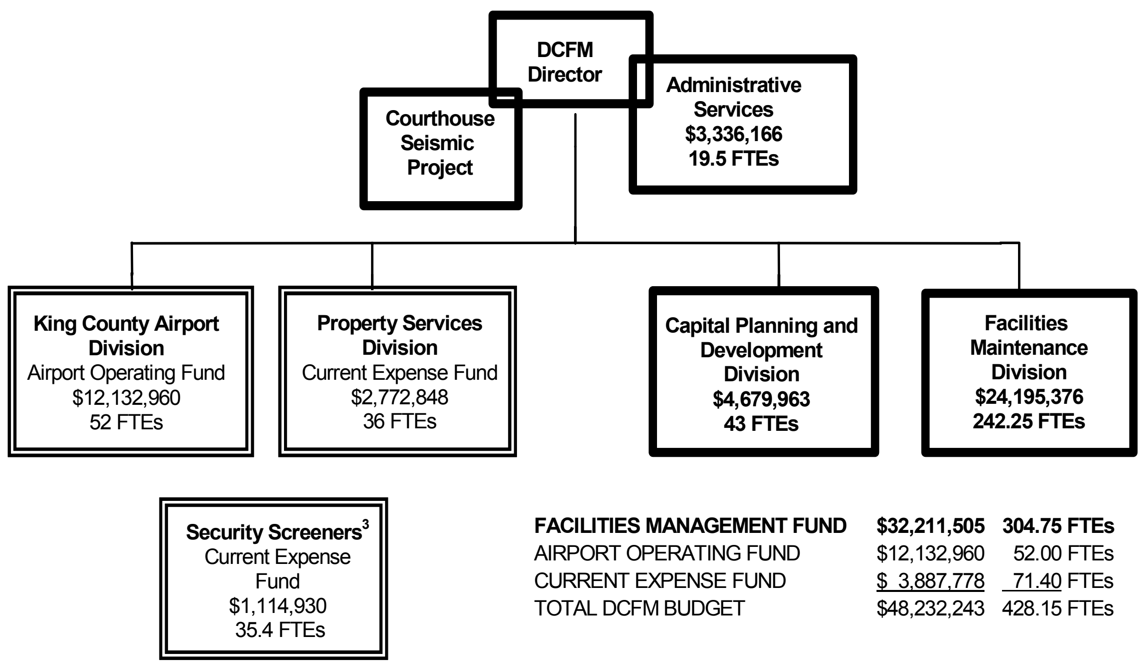
The Facilities Management Fund was established in 1995 as a result of a proviso in the 1994 adopted budget which directed that the "Department of Construction and Facility Management budgets shall be moved to an internal service fund no later than January 1, 1995." In November 1994, DCFM submitted a memo to the chair of the council's Budget and Fiscal Management Committee summarizing the rationale for creating the fund (see Appendix 1). In December 1994, the council adopted Ordinance 11591 which created the fund.

[1] The Division of Facilities Management was the Department of Construction and Facilities Management (DCFM) prior to 2002. Throughout this audit report, we refer to the division as DCFM.
[2] *Governmental Accounting, Auditing and Financial Reporting (GAAFR)*, Government Finance Officers Association, Chicago, 1994, p. 150.

Functions Supported by the Fund

Exhibit A illustrates the organizational structure of DCFM for 2001 and its sources of revenue by fund. The bold-lined boxes represent the functions supported by the Facilities Management Fund, and the double-lined boxes represent functions supported by the Current Expense (CX) and Airport Operating Funds. The 2001 adopted budget for DCFM was $48.2 million, of which $32.2 million was for the Facilities Management Fund. The budget also included 428.15 full-time equivalent (FTE) staff, 304.75 of which supported internal service fund functions.[3]

EXHIBIT A
DCFM Funding and Organization Chart for 2001



FACILITIES MANAGEMENT FUND	**$32,211,505**	**304.75 FTEs**
AIRPORT OPERATING FUND	$12,132,960	52.00 FTEs
CURRENT EXPENSE FUND	$ 3,887,778	71.40 FTEs
TOTAL DCFM BUDGET	$48,232,243	428.15 FTEs

SOURCE: 2001 Budget Documents and DCFM Staff

Audit Objective

The audit objective was to determine whether establishing the Facilities Management Fund achieved the goals identified by DCFM in 1994 as the supporting rationale for creating the fund.

[3] DCFM has budget authority for the security screeners, but the function is directed by the Sheriff's Office.

The audit specifically addressed whether administration of the fund resulted in:

- Increased accountability and visibility of costs for delivery of basic building operations and maintenance services and minor renovation work.
- Compliance with county policies and procedures and guidance provided in *Governmental Accounting, Auditing and Financial Reporting (GAAFR)* for management of internal service funds.

Audit Scope and Methodology

The audit focused on DCFM's practices related to administration of the fund and the methodology used in the 2001 rate models to establish the square foot rates for building operations and maintenance services and the hourly rates for minor renovation work. We also performed a limited review of the methodology that DCFM used to determine its total overhead costs, as well as the assumptions used to develop its financial plan and set the target fund balance. We did not review DCFM's workload and staffing levels or alternative cost allocation methodologies.

The audit methodology included:

- Interviews with county personnel from DCFM, the Finance and Business Operations Division in the Department of Executive Services, and the Budget Office.
- Review of the 2001 rate models, including the methodology used to determine the rates.
- Validation of data used in calculating the rates.
- Review of the 1996-2001 financial plans, including the criteria used to establish the target fund balance.
- Review of county and DCFM policies; procedures; operations manuals; and budget, accounting, and other financial documents.

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2 RATE MODEL METHODOLOGY

Purpose of the Facilities Management Fund

The rationale for creating an internal service fund in DCFM was that it would provide two major advantages: enhanced accountability and increased visibility of costs. Accountability would be enhanced because the fund would give agencies a clearer picture of what they were buying from DCFM and ensure that DCFM was providing all of what agencies were paying for. Visibility of costs was expected because all the costs of building operations and maintenance and minor renovation work would be captured in published rates and budgeted in the fund at their full cost.

Setting the Rates

DCFM developed models to establish the rates to charge agencies for building operations/maintenance costs and minor renovation work. There are three separate rate models:

- The square foot rate model establishes "rent" for tenants of county buildings.
- The crafts/hazmat (i.e., hazardous materials) rate model sets hourly rates for craft shop personnel for renovation work.
- The capital planning rate model sets hourly rates for the project planning portion of renovation work.

Square Foot Rate Model

The square foot rate model establishes an annual square foot rate for each county building,[4] based on three types of projected expenditures:

- Building-specific costs are charged to the building incurring them. They are expenditures unique to that building, such as utilities and custodial staff assigned to the building.

[4] The Courthouse and Administration Building are combined in the square foot rate model for a single rate.

- Overhead costs are allocated among buildings based on each building's percentage of the county's total square footage. This methodology results in every building being charged the same overhead rate per square foot. The model's overhead costs include department and division management and administration, the public parking lot at Fifth Avenue and Jefferson Street in Seattle, and a contingency factor.
- General costs are allocated in the same way as overhead. They include routine building maintenance and repairs; daytime custodial staff; and heating, ventilation, and air conditioning (HVAC) staff. The one exception is security staff. Those costs are allocated by formula, with most of the costs assigned to the Courthouse/Administration Building (see additional discussion in Finding 2-2).

Appendix 2 shows each building's square foot rate and the components of that rate. Once the rates are established, each tenant agency is assessed an annual charge based on the square feet it occupies and that building's square foot rate.

Crafts/Hazmat and Capital Planning Hourly Rate Models

The hourly rate models are intended to recover the direct and indirect costs of labor billed by the crafts/hazmat and capital planning functions. DCFM developed the hourly rate models for each function with the objective of collecting enough revenue through billable labor to meet the estimated revenue in the adopted budget. First, DCFM determined the revenue needed based on the estimated revenue in the adopted budget, adjusted for staff costs allocated to other areas of DCFM, anticipated vacancies, overhead costs, and a contingency factor.

Next, DCFM projected the revenue to be generated from billable labor for each function by estimating the number of billable hours per year and the average hourly rate for direct labor, and calculating a "burden factor" intended to recover the indirect costs of billable labor. Multiplying the burden factor by the average hourly rate yielded an average billable hourly rate; and multiplying the average billable hourly rate by the billable hours per year yielded the projected revenue. Changes in any of these factors would cause a fluctuation in the rates and amount of revenue generated. Appendix 3 provides a detailed description of how DCFM developed the hourly rate models.

General Conclusions

Our general conclusions were that the conceptual framework for the rate models was reasonable, but none of the rate models fully met the objectives of enhanced accountability and increased visibility of costs. Moreover, changes were needed in the methodology and calculations used in the models to ensure that the rates accurately reflected DCFM's costs and to provide equitable distribution of those costs.

FINDING 2-1

THE FACILITIES MANAGEMENT FUND DID NOT FULLY MEET THE OBJECTIVES OF ENHANCED ACCOUNTABILITY AND INCREASED VISIBILITY OF COSTS AS STATED IN THE FUND DEVELOPMENT PLAN.

Our audit of the Facilities Management Fund found that the fund did not fully meet the stated objectives of enhanced accountability and increased visibility of costs as stated in the "Rationale for Creating an Internal Service Fund in DCFM" (see Appendix 1). Specifically,

- Agencies were not provided sufficient information to determine what they were getting for their money.

- Allocation of some costs was inconsistent with the general methodology.
- The rates were not adjusted to account for offsetting revenues.
- The rate models were never reviewed or validated.

Agencies Were Not Provided Information to Know What They Were Getting for Their Money

The rate models were supposed to enhance accountability by providing agencies with details on the costs and services covered through the rates and increase visibility of costs through published rates for the various services provided by DCFM. However, DCFM did not provide agencies with details of what the rates included or publish the rates.

For example, agencies received quarterly invoices for their square foot charges that showed only their overall charge. If they requested details on the charges, they were informed of their rate per square foot and number of square feet. We could not identify instances where they were provided information on the components of the rate, such as the costs included for the county parking lots, security services, utilities, routine maintenance, custodial services, and overhead.

Cost estimates for work billed by the hour contained only summary level data rather than detailed data such as the number of labor hours, the hourly rate, and the specific materials and their associated costs. Although DCFM developed an average hourly rate for each function, they used these rates for estimation purposes only and did not publish or provide them to agencies in their estimates or billings.

Allocation of Some Costs Was Inconsistent With the General Methodology

The allocation of some costs in the models did not appear reasonable. For example, a disproportionately high share of department overhead was allocated to the Facilities Maintenance and the Capital Planning and Development Divisions based on FTEs and was paid by the charges generated from the square foot and hourly rate models. The models paid 97 percent of department overhead for DCFM, but accounted for only 77 percent of DCFM's FTEs.[5] On the other hand, the Property Services Division had ten percent of the department's FTEs but did not pay any department overhead.

The Airport Division, with 13 percent of DCFM's FTEs, paid three percent of the department's overhead. Its share of overhead was not based on FTEs because it paid separately for many of the costs included in department overhead. These costs were mostly county-wide internal service charges, such as the Insurance Fund and the Wide Area Network. DCFM excluded these charges from the Airport's share of overhead so that it would not pay them twice.

Square Foot Charges Did Not Reflect Staff Assignments

The formula used in the square foot model to allocate the costs of DCFM's security staff among buildings did not reflect staff assignments or benefits received[6]. Most of the costs were assigned to the Courthouse, Administration, and Yesler Buildings because they had security staff on site. However, every county building without on-site security staff paid at least $4,950 annually for security, with the rationale that the security officers at the Courthouse answered a central county telephone number at nights and on weekends. As a result, the annual square foot rates for buildings without on-site security officers ranged from $0.01 at the downtown jail to $0.66 at the Sheriff's Office precincts, while Courthouse tenants paid $0.81 per square foot for security staff on site 24 hours a day.

[5] The Director's Office is not included in the total of DCFM's FTEs since it contains the positions that are recovered through overhead.
[6] The security staff are the building security officers in the Facilities Maintenance Division and are not the security screening staff.

Costs of the daytime custodial crew were allocated evenly by square foot, in effect charging every building the same cost per square foot for the crew. However, management had no documentation of staff assignments to support the allocation, which meant that some buildings may be paying for the daytime custodial crew but receiving little or no services in return.

Finally, the costs of the parking lot at Fifth Avenue and Jefferson Street were allocated to all county buildings as overhead in the square foot rate model. DCFM management stated that the parking lot was a cost of county business and should therefore be borne by all buildings, but we question the rationale for assigning the costs of a public lot to tenant charges since the lot generates sufficient revenue to offset its costs (see further discussion of offsetting revenues below and of parking lot accounting practices in Finding 2-3).

Storage Space

Agencies were charged $5.00 per square foot for storage space, compared to as much as $12.67 per square foot for office space. However, storage space was not identified equitably in the rate model. DCFM showed only three buildings with storage space. Agencies that were not aware of the lower rate had not identified their storage space and thus were paying the higher office rates for storage. Audit staff recognize that the administrative costs of identifying and charging for additional storage space may outweigh the cost savings for agencies. However, either the charge for storage space should be applied to all agencies with storage space or the charge should not be used.

Rates Do Not Consider Offsetting Revenues

The principle of internal service funds is that they will operate on a cost-recovery basis over time, without profit or loss. This means that the funds should recover sufficient revenue to offset their costs and that all revenue associated with the costs should be considered in setting the rates. Additionally, to be consistent with *GAAFR*, revenues generated within an internal service fund from sources other than the rates (e.g., interest earned) should be used to offset costs in the rates. Because the square foot model assigns an individual rate to each building based on its costs, it is reasonable to expect that revenue generated by specific buildings would be returned to those buildings in the form of a rate reduction. However, the square foot and hourly rate models did not take into account such revenues in order to offset expenditures and reduce the rates. Instead, the revenues accumulated in the fund balance and were used to offset costs that were not recovered through the rate models. Thus, the Facilities Management Fund does not comply with the requirement that rates for an internal service fund be set on a cost-recovery basis. For example:

- The square foot rate for all tenants included the costs of the parking lot at Fifth Avenue and Jefferson Street. Although the Facilities Management Fund received $301,673 in parking revenue for this lot in 2001, none of that was used to lower tenant charges.
- The rate for the Courthouse/Administration Building included the costs of the downtown garage; and the rate for the downtown jail included the costs of its parking lot. The Facilities Management Fund received $239,386 in parking revenue for the downtown garage and $26,431 for the jail parking lot in 2001, but none of that was used to reduce tenant charges for those buildings.
- The square foot rates included the full costs of the building maintenance and HVAC crews. However, the crews also worked on an hourly basis for which the Facilities Management Fund received additional revenue of $497,963 in 2001, which was not used to offset the costs of the crews.

- The square foot rate for the Bellevue District Court included the full cost of utilities for the building although the building has non-county tenants that pay DCFM for their share of utilities.
- The Facilities Management Fund received $206,525 in interest revenue in 2001, which also was not considered as an offset in either the square foot or hourly rate models.

Rate Models Not Reviewed or Validated

The assumptions and accuracy of the calculations in both the square foot and hourly rate models were never reviewed or validated although they were developed primarily by one person. In addition, the methodologies were not fully documented, making it difficult to validate the rate models. Audit staff reviewed the assumptions, formulas, and calculations used to develop the rate models and reconstructed the models to the extent possible. Although the conceptual framework of the rate models was reasonable, we identified errors both in the rate model methodologies and supporting calculations that would likely have been identified earlier had the models been reviewed and validated. The potential impact of these errors is discussed in Finding 2-2.

Conclusion

Since agencies were not told what specific costs were included in the rates, they could not determine what they were buying, whether they were getting all of what they were paying for, or whether their rates were reasonable in comparison to the rates paid by other agencies. Publishing the rates and their cost elements (e.g., burden and contingency factors) would enable the executive, the council, and user agencies to identify any significant differences among the square foot rates, question whether the burden factors in the hourly rate models were reasonable, and identify potential cost savings. Moreover, using a consistent methodology for allocating costs and offsetting costs with corresponding revenues would meet the purpose of internal service funds, which is to operate on a cost-reimbursement basis, without profit or loss over time. Finally, reviewing and validating the rate models would provide additional assurance regarding the reasonableness of their methodologies and accuracy.

RECOMMENDATIONS

2-1-1 DCFM management should enhance accountability and increase visibility of costs by providing agencies information regarding how the square foot and hourly rates are calculated, including information on all costs factored into the rates, and publish the updated rates as revisions are made.

2-1-2 DCFM management should expand the information provided to agencies regarding charges:

- Invoices to tenants for square foot charges should include, at a minimum, the rate per square foot and the number of square feet charged.
- Estimates for billable labor should include details regarding the number of hours and cost of each type of labor estimated and details on the cost of materials to be billed to a project.
- Final statements for billable labor should be provided to agencies. The statements should include details on the number and cost of each type of labor hours and materials actually used to perform the work.

2-1-3 DCFM management should review and revise the rate models to correct inconsistent or inappropriate application of the methodology (e.g., allocation of department overhead and security costs) and errors in the assumptions and calculations.

2-1-4 DCFM management should determine whether continuing to charge a separate rate for storage space is reasonable, and if so, identify all storage space in county buildings and revise the square foot rate model to reflect that space. Otherwise, the separate rate for storage space should be discontinued.

2-1-5 DCFM management should review the Facilities Management Fund revenues generated from sources other than tenant charges and hourly billings (e.g., parking revenue, interest earned), and adjust the square foot and hourly rate models to incorporate those revenues and to ensure the fund meets the cost-recovery requirements of *GAAFR*.

2-1-6 DCFM management should arrange for a review and validation of the methodology and supporting calculations used in the rate models after implementing changes to the current rate model and after any future major changes. (The review may be done by another DCFM or executive branch employee; it is not anticipated that this should involve an outside consultant.)

FINDING 2-2 **THE CONCEPTUAL FRAMEWORK FOR THE RATE MODELS WAS REASONABLE; HOWEVER, CHANGES IN THEIR METHODOLOGY AND CALCULATIONS WOULD IMPROVE DCFM'S ABILITY TO RECOVER ITS COSTS AND DISTRIBUTE THE COSTS MORE EQUITABLY AMONG AGENCIES.**

Our audit found that the rate models did not reflect DCFM's costs of providing services and caused inequitable distribution of the costs both among the rate models and among tenant agencies. Specifically,

- The rate models were not adjusted annually to reflect actual results.
- Flaws in the rate model methodologies and calculation errors impacted both the square foot and hourly rates and thus, the projected revenues.

- A factor for building a fund balance was not incorporated into the rates.

Rate Models Not Reviewed and Adjusted Based on Prior Years' Results

The rates that DCFM charges through the square foot and hourly rate models are based on the adopted budget. Although the rates are intended to generate enough revenue to match the budgeted expenditures, the realized revenue was less than the budgeted expenditures in each of the last four years. Exhibit B shows the budgeted and actual expenditures, as well as the revenues realized, for 1998 through 2001.

EXHIBIT B

Comparison of Facilities Management Fund Budgeted and Actual Expenditures, and Revenues for 1998 – 2001

YEAR	BUDGETED EXPENDITURES	ACTUAL EXPENDITURES	REVENUES REALIZED
2001	$33,174,547	$29,553,420	$32,407,058
2000	$28,374,337	$27,103,997	$27,165,894
1999	$24,341,722	$23,750,513	$23,139,430
1998	$23,014,508	$22,819,058	$22,292,664

SOURCE: ARMS Reports – Revenue and Expenditure Summary Reports

Exhibit B shows that the revenues realized were less than the budgeted expenditures each year. The exhibit also shows that while budgeted expenditures increased each year, actual expenditures of the previous year were always less than that year's budgeted amount. While it is common for actual expenditures to vary from budgeted expenditures due to differences between estimated and actual costs and workload, it is reasonable to expect the rate models to be adjusted to reflect the prior year's actual expenditures and revenues. This would also comply with the *GAAFR* requirement that internal service funds operate without profit or loss over time. However, DCFM did not adjust the rate models based on the prior year's actual revenues and expenditures. This prevented DCFM from determining the cause(s) of the fluctuations between revenues and expenditures, as well as from determining if a rate model was causing the fund to make or lose money or whether one rate model or service was subsidizing another.

Flawed Methodology Impacted Square Foot Rates and the Projected Revenues

Square Foot Rate Model Did Not Recover All Building Costs

With the exception of the Property Services Division, DCFM did not pay for its space in county buildings nor did it track the revenue lost as a result. Audit staff calculated that approximately $760,000 was not recovered in 2001 due to non-paying tenants.[7] Instead of recovering the forgone revenue through the square foot rate model as overhead, DCFM was apparently relying on parking and other fund revenues to make up the difference. This practice was not consistent with the purpose of internal service funds, which is to operate on a cost-reimbursement basis.

New Methodology in 2002 Square Foot Rate Model Penalizes Agencies in Buildings Occupied by DCFM

DCFM changed the methodology in the 2002 rate model to recover the foregone tenant charges. The revised methodology allocated each building's charges among its billable square feet (i.e., space occupied by paying tenants) rather than all square feet. This increased the square foot rate in buildings where DCFM was a major tenant and shifted much of the cost of DCFM space to tenants of those buildings. The square foot rate for the Yesler Building increased by $1.67 (16 percent) and the Courthouse/Administration Building rate increased by $1.30 (14 percent), while the rates for many other buildings decreased. In addition, the 2002 model excluded storage space from billable square feet, but DCFM is continuing to bill for storage space at $5.00 per square foot. Thus, DCFM will recover the costs of identified storage space twice: by allocating its costs among buildings' billable square feet and by billing agencies directly for

[7] A few non-county tenants also do not pay a square foot charge (e.g., the State Auditor's Office), but almost all (95 percent) of the free space is occupied by DCFM.

their storage space. However, these changes still did not result in projected revenue from tenant charges meeting projected expenditures due to errors in model methodology and calculations.

Impact of Reallocating Free Space as Overhead

Audit staff recalculated the 2002 rate model to determine the impact of allocating free tenant space more equitably as overhead among all county buildings. This methodology would reduce the wide variation in rate changes that occurred in the 2002 model. It would increase the square foot rate by $0.19 for all buildings where DFCM is not a tenant, and lower the rates for the Yesler Building and Courthouse/Administration Building by $0.57 and $0.34, respectively. The distribution of charges between current expense (CX) and non-CX agencies would not change.

Flawed Methodology and Calculation Errors in Hourly Rate Models Directly Impacted Projected Revenue

We found two major flaws in the hourly rate models that resulted in a miscalculation of the revenue that DCFM projected from billable labor. First, the burden factors were forced and did not reflect actual overhead costs, and second, several supporting calculations contained errors.

Burden Factors for Hourly Rate Models Are Backed Into Based on the Budget

The burden factors used in the hourly rate models were intended to recover costs not directly billable to projects. DCFM determined the burden factors by backing various numbers into the adjusted budgeted revenue until it reconciled with the projected revenue from billable labor (see detailed discussion in Appendix 3). DCFM staff then calculated certain components of the burden factor (i.e., employee benefits, holidays, paid absences, supplies, and nonbillable time worked) by converting them into a percentage of total paid hours or salaries, but they did not do this for the final component, administrative overhead. Instead, they used a “plug figure” that was the difference between the burden factor and the sum of the calculated components of the burden factor. This approach meant that the burden factor was simply the number that would yield the difference between the revenue needed and the revenue to be generated from actual billings.

The burden factor was also inflated by adding a contingency to the estimated nonbillable time. The contingency, which was a percentage of total paid hours, was 15 percent for capital planning staff and five percent for crafts/hazmat staff. We agree with the theory of adding a contingency to nonbillable time; however, we believe the contingency should be based on the average nonbillable time rather than the total paid hours since the nonbillable hours are where the fluctuations will occur. Using the same percentages that DCFM used in this calculation, but applying them to the nonbillable time, would have reduced the contingency from 274 to 56 hours per FTE for capital planning staff and from 104 to 20 hours for crafts/hazmat staff. This would have caused a corresponding 12 percent reduction in the burden rate for the capital planning staff and a four percent reduction for the crafts/hazmat staff.

On the surface, it seems reasonable that backing into the burden factor would result in the percentage needed to recover the overhead costs and would reconcile the projected revenue from billings with the revenue in the adopted budget. This methodology would always result in the two numbers reconciling since the burden factor is forced. However, it does not produce an accurate burden factor when there are errors in the supporting computations; and the impact is compounded when there are multiple errors, as was the case in both of the hourly rate models. Moreover, the methodology of backing into the burden factor conflicts with the basic premise of internal service funds because the hourly rates were calculated to meet the budgeted revenue rather than to recover costs.

If DCFM had converted the actual administrative overhead to a percentage of salaries and compared the result with the plug figure they backed into, they would have seen that these numbers did not match in either the capital planning or crafts/hazmat hourly rate model. This in turn should have caused them to question why backing into the burden factor did not produce an appropriate result and led them to identify errors in the supporting assumptions and calculations.

Errors in Assumptions and Calculations Resulted in a Miscalculation of Projected Revenue

Our analysis of the hourly rate models included recalculations of the annual billable hours, average hourly rates and burden factors for the capital planning and crafts/hazmat functions. We identified errors in the assumptions and calculations that caused, at least in part, the plug number that DCFM calculated for administrative overhead through its iterative process to not match the actual administrative overhead. These errors included:

- Underestimating the annual billable hours per FTE for both capital planning and crafts/hazmat staff – This occurred because the annual billable hours were based on estimates by supervisory staff rather than verified data. It is important to note, however, that our recalculation of the annual billable hours was based on actual payroll and administrative hours only and did not include verification of the actual number of hours billed.
- Underestimating the average hourly rate for capital planning staff and overestimating it for crafts/hazmat staff – This resulted from a combination of errors in methodology and calculations.

- Overestimating the burden factor for capital planning staff and underestimating it for crafts/hazmat staff – This occurred because the benefits factor and nonbillable paid time were not verified against available data, and because the factor for administrative overhead was a plug number rather than being based on the actual amount of overhead required to be recovered through the rate model.

Exhibit C provides a summary of the impact of these errors on the revenue projections for 2001, and Appendix 3 provides details on the impact of these errors.

EXHIBIT C

Impact of Errors in Hourly Rate Models on Projected Revenue for 2001

	DCFM RATE MODEL	AUDIT STAFF RECALCULATION	PROBABLE REVENUE COLLECTIONS	ACTUAL REVENUE COLLECTED
Capital Planning				
Average Billable Hourly Rate	$92.02	$88.73	$104.44	
x Total Billable Hours	x 45,152	x 45,297	x 45,297	
= Projected Revenue	*$4,154,732	*$4,018,983	*$4,730,833	$4,610,478
Crafts/Hazmat				
Average Billable Hourly Rate	$54.36	$50.82	$48.48	
x Total Billable Hours	x 56,795	x 57,204	x 57,204	
= Projected Revenue	*$3,087,508	*$2,906,867	*$2,773,524	$2,639,234

*Difference between calculated result shown and actual result is due to rounding during interim steps.

SOURCE: DCFM Hourly Rate Model Spreadsheets and Payroll Data

The DCFM Rate Model column in Exhibit C shows the revenue that DCFM projected from direct billings for capital planning and crafts/hazmat staff, and the Audit Staff Recalculation column shows the amount that would have been realized by correcting the average billable hourly rate and the total billable hours. The Probable Revenue Collections column shows the amount that DCFM was likely to collect. It is based on audit staff corrections to the total billable hours and the average hourly rate component of the average billable rate per hour, but includes DCFM's calculated burden factors.[8] This column shows that using an incorrect burden factor was likely to cause DCFM to collect too much revenue for capital planning staff and insufficient revenue for crafts/hazmat staff, as well as the compounded effect of multiple errors in the components of the rate model. Finally, the Actual Revenue Collected column shows the amount DCFM collected for billable labor during 2001. The difference between the actual revenue and our estimate of probable revenue collections is likely due to fewer direct labor hours being billed than were estimated[9] and differences between the average hourly rate per hour and the actual rates of the employees performing the work.[10] Also, vacancies in positions charged to overhead could have caused the administrative overhead component of the burden factor to be overstated.

Exhibit C illustrates that using incorrect factors in the hourly rate models can have a significant impact on the actual revenue collected. In this case, it resulted in the capital planning function subsidizing other costs in the Facilities Management Fund and the crafts/hazmat function being subsidized by revenues from other functions in the fund. It also resulted in DCFM collecting approximately $456,000 (11 percent) more than it projected for capital planning billable labor and approximately $448,000 (14.5 percent) less than it projected for crafts/hazmat billable labor.

Errors in Crafts/Hazmat Hourly Rate Model Could Have More Significant Impact in 2003

DCFM management indicated that, beginning in 2003, they are considering using the crafts/hazmat hourly rate model for labor

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[8] Since DCFM's calculated burden factors were programmed into the billing system, the revenue likely to be collected would have been based on that burden factor rather than our corrected burden factor.

[9] A hiring freeze imposed on all county departments prevented DCFM from filling its vacancies, which would have resulted in fewer billable hours than what they had estimated.

[10] Because billings are based on the actual hourly rate of the employee performing the work, any differences in the mix of employees performing the work would cause a corresponding change in the average hourly rate and the projected revenue.

costs currently allocated through the square foot rate model. If implemented, this change could cause the impact of errors in the hourly rate model to grow proportionately with the increase in FTEs billed through the model.

High Burden Factors Raise Question of Reasonableness

The high amount of the burden factors in the hourly rate models, as well as the difference between the burden factors for capital planning and crafts/hazmat staff, raise a question of their reasonableness. Although our recalculations showed that the capital planning burden factor should have been almost half a percentage point less (1.71 vs. 2.19) and that the crafts/hazmat burden factor should have been slightly higher (1.18 vs. 1.08) than those calculated by DCFM, we believe that further analysis, such as a review of the workload billed through the hourly rate models, may indicate that these rates could vary even more. The Auditor's Office will conduct an analysis of DCFM's workload and staffing as part of its 2002 work program.

Factor for Fund Balance Not Built Into Rates

Accounting literature explains that internal service funds should be used *only* if a government intends to recover the full cost of providing a service, including depreciation expense. This means, for example, that an allowance must be made in the rates for replacement of fixed assets. Such an allowance will cause an internal service fund to have a positive balance in some years, but that balance will decline as fixed assets are replaced.

Neither the square foot rate model nor the hourly rate models included a depreciation factor to cover the replacement costs of fixed assets. The models also did not include a factor to provide a fund balance to meet cash flow requirements to support immediate operating expenses and emergency or unanticipated expenditures. Although the Facilities Management Fund had a positive fund balance in 2001, it was due to errors in the rate models rather than a planned methodology for accruing a fund balance. The fund had a negative balance in other years, partially due to the fact that there was no allowance for asset replacement, cash flow requirements, and emergency or unanticipated expenditures in the rate models. Establishing criteria for accruing a fund balance is necessary for the Facilities Management Fund to fully operate under the accounting principles established for internal service funds (see additional discussion in Chapter 3).

Conclusion

The rates charged to tenant agencies through the square foot and hourly rate models did not fairly reflect DCFM's actual costs. Moreover, flaws in the methodologies used to develop the rate models and errors in supporting calculations resulted in inequitable distribution of costs both among the rate models and among tenant agencies.

RECOMMENDATIONS

2-2-1 DCFM management should compare each year's actual and projected revenues and expenditures, analyze the differences to determine their cause, and revise the rate models accordingly.

2-2-2 DCFM management should revise the square foot rate model to allocate the costs of free tenant space as overhead to all tenants. The model should also be revised to include only costs that are appropriate for recovery through tenant charges, and ensure that costs reflect services provided.

2-2-3 DCFM management should revise the methodology used to calculate the burden factor in the hourly rate models so it reflects the actual costs of the burden factor components (i.e., benefits, absences, overhead, and administrative time). The current process for calculating the burden factor should be used to double check the accuracy of the calculated factor and to identify errors in the hourly rate models. DCFM management should also ensure that verified data is used in lieu of supervisory estimates for the benefits, absences, and administrative time.

2-2-4 DCFM management should develop a plan for asset replacement and use the plan as a basis for incorporating a factor into the square foot and hourly rate models to build a fund balance as required by the county's financial policies. The designated portion of the fund balance should be clearly identified as such in the Facilities Management Fund's financial plans.

FINDING 2-3 ACCOUNTING FOR THE REVENUES AND EXPENDITURES OF THE COUNTY PARKING LOTS IS INCONSISTENT WITH THE REQUIREMENTS FOR INTERNAL SERVICE FUNDS AND DOES NOT COMPLY WITH STATE LAW.

Proprietary Funds

Governments account for their business-type activities through proprietary funds that focus on cost and cost recovery. There are two types of proprietary funds: internal service and enterprise. Internal service funds account for centralized intragovernmental services on a cost-reimbursement basis, without profit or loss over time. Enterprise funds account for activities that operate similar to a private business, have customers that often include the public, and may earn a profit.

The Facilities Management Fund contains three parking lots: the county garage, the downtown jail garage, and the lot at Fifth Avenue and Jefferson Street. The lots contain a mix of agency, motor pool, public, and employee parking spaces. All of the costs and a portion of the revenue for the lots are included in the Facilities Management Fund, with the balance of the revenue earmarked for the Children and Family Set-Aside Fund.

Accounting Practices for Parking Lots Should Be Reviewed

Including all the costs of the parking lots in the Facilities Management Fund imposes a requirement on the county to also account for the revenues and expenditures for those services on a cost-reimbursement basis, consistent with the requirements for internal service funds. However, we found that the accounting practices for the parking lots were inconsistent with these requirements because the costs were not discretely accounted for and the rates were set at market rather than on a cost-reimbursement basis. Moreover, earmarking a portion of the parking revenue to the Children and Family Set-Aside Fund is inconsistent with the accounting requirements of internal service funds and does not comply with state law.

Parking Lot Costs Were Not Discretely Accounted For

Generally accepted accounting principles require that rates for services provided through internal service funds accurately reflect the cost of providing those services. This means that the costs must be accounted for in a manner that will allow them to be separately identified. Although DCFM discretely accounted for the costs of the parking lot at Fifth and Jefferson, they combined the costs of the county garage with those of the Courthouse/Administration Building and the costs of the downtown jail garage with those of the jail. This accounting practice meant that there was not a reliable method for determining what the rates should be in order to recover costs.

Rates Were Not Set On a Cost-Reimbursement Basis

The rates for the county parking lots are set through an ordinance adopted by the Metropolitan King County Council and are based on market rates rather than on costs.

In 2001, the rates per stall in the county garage and jail parking lot were $110 per month for reserved parking and $100 for unreserved parking. These rates, which are charged to both county agencies and employees who pay for parking, generated $615,562 in 2001. However, because DCFM did not discretely account for the costs of the county garage and jail parking lot, we were unable to determine whether the rates complied with the cost-recovery requirements for internal service funds or generated a profit.

The rate per stall for parking at the lot on Fifth and Jefferson was $75 per month for reserved parking; hourly rates were charged for unreserved parking. These rates generated $301,673 in 2001 while the actual costs were $64,687. The large difference between the costs and revenues indicates that the parking lot earned a profit and therefore did not comply with the rate setting requirements of internal service funds.

Enterprise or Current Expense Fund May Be More Appropriate Means of Accounting for Parking Lots

The agency and motor pool parking spaces are centralized intragovernmental activities, since DCFM is providing space for county vehicles, and could be appropriately accounted for through an internal service fund. However, to comply with the accounting requirements for an internal service fund, the rates for these spaces should be determined on a cost-recovery rather than a market basis. On the other hand, the public and employee parking are similar to a private business operation, since the county is providing services to the public at market rates, and may be more appropriately accounted for through an enterprise fund. Alternatively, because a portion of the revenues are allocated to the Children and Family Set-Aside Fund, moving the parking lots into the Current Expense (CX) Fund may be the most appropriate option.

Allocation of Some Parking Revenue to Children and Family Set-Aside Fund May Conflict With State Law

Section 43.09.210 of the Revised Code of Washington (RCW) states that all service rendered by a department shall be paid for at its true and full value by the receiving entity, "and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another." The ordinance allocating a portion of parking revenue to the Children and Family Set-Aside Fund sets a threshold so that the revenue exceeding the 1989 level goes into the fund, with the balance going into the Facilities Management Fund. In 2001, the Facilities Management Fund received $567,490 in parking revenue and the Children and Family Set-Aside Fund received $349,745. DCFM identifies the portion of the revenue to be allocated between the two funds upon receipt; thus, the portion allocated to the Children and Family Set-Aside Fund never goes into the Facilities Management Fund.

However, because the parking lots have been identified by the county as internal service fund activities, the allocation of a portion of the parking revenue to another fund means that the Facilities Management Fund is benefiting the Children and Family Set-Aside Fund. This practice is inconsistent with the accounting requirements for internal service funds and is not in compliance with the RCW.

Accounting Practices for Parking Lots Should Be Reviewed

A review of the accounting practices for the parking lots is justified based on the mixed use of the lots, the need to set rates for the Facilities Management Fund on a cost-reimbursement basis, and the fact that a portion of the parking revenues are allocated to a subfund of the CX fund. Factors to consider in determining the most appropriate type of fund to account for parking lot revenues and expenditures are whether the parking lots serve primarily internal customers (i.e., county agencies) or external customers (i.e., the public), and whether the county's intent is to recover the cost of services or to earn a profit on parking revenue.

If the customers are primarily internal and the intent is recovery of costs, the revenues and expenditures could continue to be accounted for in an internal service fund, but the rates should be reduced to comply with the break-even concept of internal service funds. If the customers are primarily external and the priority is to earn a profit, the rates can continue to be set at market, but the accounting should be through an enterprise fund or the Current Expense Fund. If the priority is to continue to raise revenue for the Children and Family Set-Aside Fund, the parking lots should be moved to the Current Expense Fund. Regardless of which priority drives the decision, the accounting practices must be consistent with generally accepted accounting principles for the type of fund used.

Parking Lot Issues Discussed With State Auditor's Office

We discussed the issues regarding discrete accounting for the parking lot revenues and expenditures, the need for internal service funds to be accounted for on a cost-recovery basis, and the allocation of parking revenues to the Children and Family Set-Aside Fund, with staff from the State Auditor's Office. The State Auditor's Office concurred with our concerns.

Conclusion

Accounting practices for the county's parking lots do not comply with the accounting requirements for internal service funds. Additionally, the mixed use of the parking lots, market-based rates, and allocation of a portion of the parking revenue to a special fund suggest that these activities should be reviewed to determine whether an internal service fund or an enterprise fund is the most appropriate method of accounting for the parking lots' revenues and expenditures. Alternatively, accounting for parking lot revenues and expenditures through the CX Fund would allow a portion of the revenues to continue being set aside for the Children and Family Set-Aside Fund.

RECOMMENDATIONS

2-3-1 DCFM management should review the accounting practices for the county parking lots and determine whether their costs would be more appropriately accounted for in an enterprise fund or the CX Fund, or retained in the Facilities Management Fund. If it is determined that any or all of the lots should remain in the Facilities Management Fund, DCFM management should establish a method to discretely account for the parking lot costs and recommend a revised rate-setting methodology to the Metropolitan King County Council to ensure that the rates meet the cost-reimbursement requirements for internal service funds.

2-3-2 The Metropolitan King County Council should consider working with staff from the Prosecuting Attorney’s Office and the State Auditor’s Office to review the ordinance allocating a portion of the parking revenue to other funds to ensure the practice does not violate RCW provisions.

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3 FINANCIAL PLAN AND FUND BALANCE

Purpose of a Financial Plan and Fund Balance

The county requires each non-CX fund to have a financial plan that calculates the funds available for additional appropriation and tracks the health of the fund (see Appendix 4 for a discussion of the financial plan). The financial plans must include both an ending fund balance and an ending designated fund balance. Fund balances enable the fund to support its immediate operating expenditures, prevent significant fluctuations in rates, and provide for asset replacement and unanticipated expenditures. Large surpluses or deficits in an internal service fund over time may be an indication that other funds were not charged properly for the goods and services they received. Thus, regular monitoring of the fund balance, primarily through the financial plan, is essential for ensuring that rates charged to user agencies are appropriate.

General Conclusions

We found that the financial plan for the Facilities Management Fund was adequately prepared and presented. However, instructions provided by the Budget Office on how to develop the financial plans for quarterly and annual budget reports were not well written. We also found that the financial plan was not effectively used as a financial management tool to monitor the fund balance and that it did not comply with the county's financial policies for internal service funds.

FINDING 3-1

THE FINANCIAL PLAN FOR THE FACILITIES MANAGEMENT FUND WAS ADEQUATELY PREPARED AND PRESENTED. HOWEVER, WRITTEN INSTRUCTIONS PROVIDED BY THE BUDGET OFFICE FOR PREPARING FINANCIAL PLANS FOR THE COUNTY'S INTERNAL SERVICE FUNDS WERE INADEQUATE.

Financial Plans Presented on a "Readily Available Resources" Basis

The Budget Office provides instructions to agencies on how to prepare financial plans for the county's internal service funds. The instructions require the financial plans to be presented on a "readily available resources" basis. In effect, the financial plan shows the beginning balance, consisting of cash or other net assets readily convertible into cash, and the cash inflows and outflows from the current operations to arrive at the ending fund balance, which represents the net current assets available to finance the immediate needs of the following fiscal period's operations.

Financial Plan Reflected the Readily Available Resources

We reviewed the financial plans of the Facilities Management Fund for the years 1998 to 2000, included as Appendix 5. For further analysis, we independently recalculated these financial plans (shown as "Actual Auditor's" columns) and compared them with the financial plans prepared by DCFM ("Actual DCFM" columns). We found that, except for minor classification differences in the 1998 results, the financial plans were prepared to fairly reflect the readily available resources.

Instructions and Training for Preparing Financial Plans Were Inadequate

However, we noted that the Budget Office's guidance for preparing the financial plans was not clearly written. The instructions do not provide clear definitions of terms, references to available schedules are outdated, and the examples provided are not comprehensive or reflective of common transactions to county funds. Moreover, there is no discussion of how to adjust revenues and expenditures for noncash transactions such as depreciation expense. We also found that county staff were not adequately trained in how to prepare financial plans. Thus, many fund managers, including DCFM, rely on assistance from an accountant in the Finance and Business Operations Division, Department of Executive Services, to prepare their financial plans. The lack of clear instructions and the reliance on a single individual for financial plan preparation increase the potential for errors and inconsistency, both from year to year and among the various funds.

RECOMMENDATIONS

3-1-1 DCFM (and other proprietary fund agencies) should work with the Finance and Business Operations Division and the Budget Office to prepare clearly written financial plan instructions, including comprehensive examples and a glossary of terms with improved definitions.

3-1-2 Finance and Business Operations Division should conduct periodic training for agency and Budget Office personnel so that instructions for preparing the financial plans are clearly understood and the process is consistently applied.

FINDING 3-2 **THE FACILITIES MANAGEMENT FUND'S FINANCIAL PLAN IS NOT EFFECTIVELY USED AS A MANAGEMENT TOOL, RESULTING IN SUBSTANTIAL FLUCTUATIONS IN THE FUND BALANCE. MOREOVER, THE FUND DOES NOT COMPLY WITH THE COUNTY'S FUND BALANCE POLICY FOR NON-CX FUNDS.**

County Financial Policies

The King County Council adopted financial policies for the county in Motion 5888, including criteria for establishing an appropriate "positive anticipated unencumbered fund balance" for non-CX funds. Although the appropriate level of a fund balance is dictated by the specific characteristics and purpose of each fund, all fund balances are to be established to avoid large rate increases from one year to the next. The criteria listed in the adopting motion include:

- Cash flow requirements to support operating expenses.
- Relative rate stability.
- Susceptibility to emergency or unanticipated expenditures.

Development Plan for the Facilities Management Fund Was Consistent With County Financial Policies

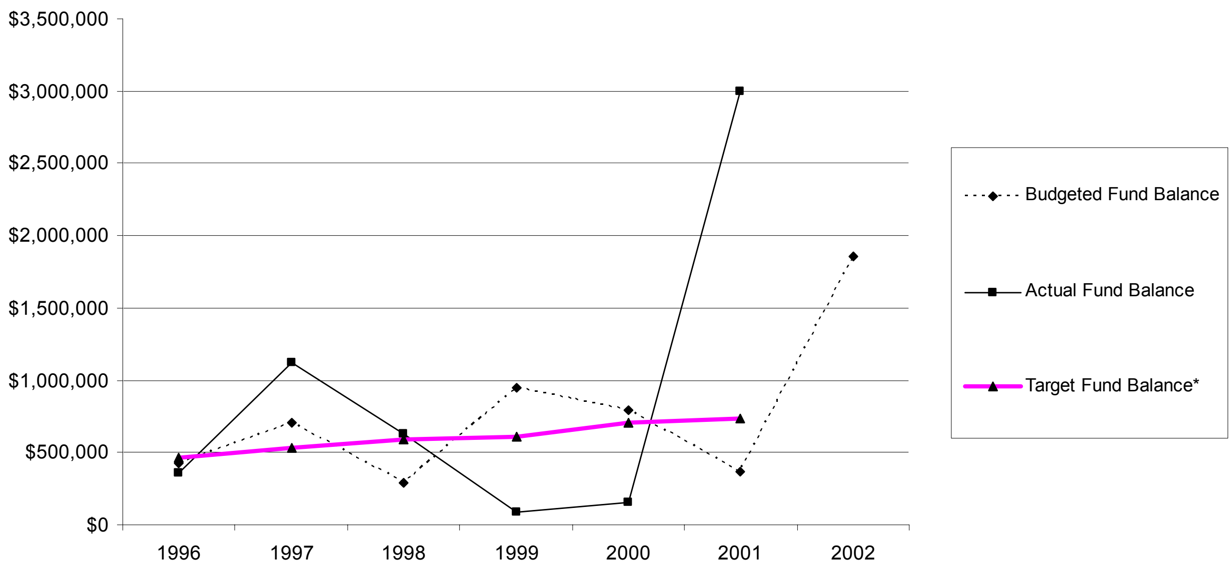
The Facilities Management Fund's development plan contained criteria for creating a "financially sound fund," including a prudent margin for operating expenses and a fund balance reserve for unexpected emergencies and planned charges such as cost of living increases. The plan also specifically stated the need to factor an equipment replacement schedule into the rates charged for building maintenance. These criteria met the requirements of the county's financial policies and the guidance established in *Governmental Accounting, Auditing and Financial Reporting (GAAFR)*, which states that recovering the full cost of providing goods and services through an internal service fund includes the systematic recovery of the replacement cost of fixed assets.

Fund Balance Fluctuated Significantly From Year to Year

The financial plan instructions require a computation and presentation of a target fund balance to meet the fund's immediate cash and other needs. DCFM has established a target fund balance of "one pay period's wages and benefits" (or approximately 2.6 percent of total operating expenditures) for the Facilities Management Fund. (DCFM has revised the target fund balance policy to five percent of the operating expenditures in 2002 and future years. However, we did not see any specific discussion justifying this increase in the target fund balance.) Exhibit D compares the budgeted, actual, and target fund balances of the Facilities Management Fund for the years 1996 through 2001, and the budgeted fund balance for 2002 (see Appendix 5 for the 1998 – 2001 data).

EXHIBIT D

Comparison of Budgeted, Actual, and Target Fund Balances for 1996 – 2002



*The target fund balance presented in this exhibit is calculated on the fund's actual expenditure.

SOURCE: Executive Budget Books

Actual Fund Balance Differs Significantly From the Budgeted and Target Fund Balances

Exhibit D shows that the target Facilities Management Fund balance is relatively constant at $0.5 to $0.75 million. However, the actual fund balance has fluctuated significantly from more than twice the target in 1997 to only a small fraction of the target at the end of 1999 and 2000. DCFM closed 2001 with a fund balance that was four times its immediate needs.[11] (It should be noted that, as a result of a council budget action, approximately $1.45 million of the expected fund balance for 2001 is being used to reduce the square foot rates for 2002.) Since the target fund balance is based on actual (or budgeted) total operating

[11] The Comprehensive Annual Financial Report has not been completed for 2001; thus, the "actual" fund balance is based on the latest available ARMS data.

expenditures, this is an indication of significant differences between the forecasted and actual expenditure levels.

Fund Did Not Comply With County Financial Policies Regarding Fund Balances

Additionally, as discussed in Finding 2-2, one of the causes of the fluctuations in the fund balance is that a factor for building a fund balance was not incorporated into the rates, although such a factor is required in the county's financial policies and in the guidance provided by *GAAFR*. In the years where a positive fund balance did accrue, it was due to errors in the rate models rather than a planned methodology for accruing a balance that would allow DCFM to meet its immediate operating needs and replace fixed assets over time.

Fluctuations in the Fund Balance May Indicate Improper Charges for Services and Could Disrupt DCFM Operations

GAAFR states that "surpluses and deficits in internal service funds may be an indication that other funds were not charged properly for the goods or services they received." As discussed in Finding 2-2, inadequate methodology and errors in the rate models, combined with the lack of a factor for building a fund balance, have resulted in improper charges to tenant agencies for services provided through the Facilities Management Fund. This could potentially cause fluctuations in the rates charged to tenant agencies, thereby affecting those agencies' ability to forecast reliable internal service charges and/or their ability to purchase other necessary goods or services. Moreover, the significant fluctuations in the fund balance endanger the fund's self-sufficiency, and a fund balance that is less than the target fund balance could potentially disrupt DCFM's operations if cash resources were insufficient to finance its immediate operating needs.

Financial Plans Should Be More Effectively Used as a Management Tool

In accordance with county policy, the financial plan should be used as a management tool to monitor the financial health of the fund and maintain a stable fund balance. This should include monitoring the fund on an exception basis to identify significant differences among revenues, expenditures, and fund balance levels to minimize the potential for significant variances in the rates charged to tenant agencies by making adjustments to the rates. However, DCFM management did not analyze the significant differences in the fund's target versus actual balances to determine the cause(s) and recover the shortfall or rebate the excess through rate adjustments.

Also in accordance with county policy, the financial plan should include an ending fund balance and an ending designated fund balance. Although the development plan for the Financial Management Fund stated the intent to provide financial stability by including funding for its immediate operating expenses, capital asset replacement, and emergencies, there were no specific designations of the fund balance for these purposes.

RECOMMENDATIONS

3-2-1 DCFM management should use the financial plan more effectively as a financial management tool, to facilitate early detection of a potentially excessive fund surplus or deficit, and to correct such a surplus or deficit through a rate adjustment.

3-2-2 DCFM management should develop a plan that would identify the necessary amount for a fund balance reserve, such as replacement costs or emergency needs, and designate the fund balance in its financial plans. Additionally, such a reserve should be factored into the square foot and hourly rate models to build actual resources for the designated purposes.

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